Supreme Court U.S.
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No.

IN THE
SUPREME COURT OF THE UNITED STATES
OCTOBER TERM 1998

Seko Investments, Inc.,
a Nevada corporation,

Petitioner,

v.

Chicago Title Insurance Company,
a Missouri corporation,

Respondent.

ON PETITION FOR WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

PETITION FOR WRIT OF CERTIORARI

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QUESTIONS PRESENTED

Bankruptcy Code § 303 provides that, to qualify as the sole petitioner in an involuntary bankruptcy, the petitioning creditor must hold an unsecured claim against the debtor of at least $10,000 "that is not contingent as to liability or the subject of a bona fide dispute". Here the Petitioner presented evidence that it was owed roughly $1,000,000 by the Alleged Debtor, the Alleged Debtor presented evidence that the Petitioner owed the Alleged Debtor $3,500,000, and the Bankruptcy Court concluded, consistent with the law in at least five other circuits, that, ". . . when the totality of the circumstances are considered it is clearly uncertain whether [Alleged Debtor] owes [Petitioner] money or [Petitioner] owes [Alleged Debtor] money." It dismissed the involuntary petition and the Bankruptcy Appellate Panel consisting of three Bankruptcy Judges affirmed, concluding that the Petitioner did not have a claim of at least $10,000 that was not subject to "a bona fide dispute". The Ninth Circuit Court of Appeals reversed, ruling that counterclaims, expressly recognized as a defense under Bankruptcy Rule 1011, should be limited to those in the nature of recoupment, evidence of a set off having been improperly considered. The issues may be stated as follows:

1. In defense of an involuntary bankruptcy petition, where persuasive evidence has been presented that the claim of petitioning creditor may have been paid in full by an offset, is the claim of the petitioning creditor "the subject of a bona fide dispute" within the meaning of 11 U.S.C. § 303?

2. Alternately stated, whether the Ninth Circuit was correct in ruling that,

"The practice of netting out the claims of

> debtors and their creditors only makes sense when a counterclaim for recoupment on a creditor's claim is involved. Such a counterclaim arises only out of the same transaction which forms the basis of the creditor's claim ...",

a ruling which is diametrically opposed not only to the plain meaning of the statute and common sense, but also contrary to the express ruling of the Eighth Circuit and implicit rulings of at least four other Circuit Courts of Appeals.

2. Whether the counterclaims at issue are, as a matter of law, setoff or recoupment?

3. Whether a dispute as to whether a defense to the claim of petitioning creditor is in fact a setoff or recoupment will itself qualify as a basis to conclude that the claim is "the subject of a bona fide dispute."

LIST OF PARTIES

The parties to the proceeding below were Seko Investments, Inc., a corporation, and Chicago Title Insurance Company, a corporation.

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PETITION FOR WRIT OF CERTIORARI

Seko Investments, Inc, the Petitioner herein, prays that a writ of certiorari issue to review the Opinion of the United States Court of Appeals for the Ninth Circuit entered in the above-entitled case on September 28, 1998.

OPINIONS BELOW

The original published OPINION of the United States Court of Appeals for the Ninth Circuit, filed September 28, 1998, is reprinted as Appendix B to this Petition.

The unpublished ORDER of the United States Court of Appeals for the Ninth Circuit, filed November 13, 1998, denying a petition for rehearing and rejecting suggestion for rehearing en banc in is reprinted as Appendix A to this Petition.

The unpublished OPINION of the Bankruptcy Appellate Panel for the Ninth Circuit, filed August 28, 1996, is reprinted as Appendix C to this Petition.

The trial court's rulings are not published. The CONCLUSIONS OF LAW by the Bankruptcy Court trial judge from the transcript of the October 20, 1994 hearing on the Motion for Summary Judgment in the United States Bankruptcy Court for the Central District of California, are reproduced in Appendix D to this Petition.

The MEMORANDUM OF DECISION of the United States Bankruptcy Court for the Central District of California, filed August 28, 1996, is reprinted as Appendix E to this Petition.

JURISDICTION

This petition seeks review of a final judgment of the Court of Appeals for the Ninth Circuit. This Court's jurisdiction is invoked pursuant to 28 U.S.C. § 1254(1). Jurisdiction of the Circuit Court arose under 28 U.S.C. § 1291 which reviewed a final judgment of the Bankruptcy Appellate Panel which reviewed a final decision of the Bankruptcy Court who has jurisdiction to determine all cases under title 11 pursuant to 28 U.S.C. § 157(b).

STATUTES INVOLVED

This case seeks to determine the cognizable defenses available to an alleged debtor to defend against an involuntary bankruptcy petition filed pursuant to provisions of Title 11, United States Code. 11 U.S.C. § 303, in pertinent part, provides:

> 303. Involuntary Cases
>
> . . .
>
> (b) An involuntary case against a person is commenced by the filing with the bankruptcy court of a petition under chapter 7 or 11 of this title—
>
> > (1) by three or more entities each of which is either a holder of a claim against such person that is not contingent as to liability or the subject of a bona fide dispute, or an indenture trustee representing such a holder, if such claims aggregate at least

> $10,000 more than the value of any lien on property of the debtor securing such claims held by the holders of such claims;
>
> (2) if there are fewer than 12 such holders, excluding any employee or insider of such person and any transferee of a transfer that is voidable under section 544, 545, 547, 548, 549, or 724(a) of this title, by one or more of such holders that hold in the aggregate at least $10,000 of such claims".

Bankruptcy Rule 1011 provides as follows:

> "Rule 1011. Responsive Pleading or Motion in Involuntary and Ancillary Cases.
>
> (a) Who May Contest Petition.
>
> The debtor named in an involuntary petition or a party in interest to a petition commencing a case ancillary to a foreign proceeding may contest the petition. In the case of a petition against a partnership under Rule 1004(b), a nonpetitioning general partner, or a person who is alleged to be a general partner but denies the allegation, may contest the petition.

(b) Defenses and Objections; When Presented.

Defenses and objections to the petition shall be presented in the manner prescribed by Rule 12 FR Civ P and shall be filed and served within 20 days after service of the summons, except that if service is made by publication on a party or partner not residing or found within the state in which the court sits, the court shall prescribe the time for filing and serving the response.

(c) Effect of Motion.

Service of a motion under Rule 12(b) FR Civ P shall extend the time for filing and serving a responsive pleading as permitted by Rule 12(a) FR Civ P.

(d) Claims Against Petitioners.

A claim against a petitioning creditor may not be asserted in the answer except for the purpose of defeating the petition.

(e) Other Pleadings.

No other pleadings shall be permitted, except that the court may order a reply to an answer and prescribe the time for filing and service." (Emphasis added).

STATEMENT OF THE CASE

Chicago Title Insurance Company ("CTIC") and Seko Investment, Inc. ("Seko") were engaged in litigation in state court, CTIC claiming it was owed one million dollars by Seko and Seko claiming it was owed three and one half million dollars by CTIC. Ten days before a scheduled multi-week jury trial to hear testimony from dozens of witness and consider scores of documentary exhibits, CTIC filed an involuntary bankruptcy petition against Seko which automatically stayed and delayed the trial. At the conclusion of proceedings in the Bankruptcy Court the Bankruptcy Judge concluded that,

> ". . . when the totality of the circumstances are considered it is clearly uncertain whether Seko owes Chicago Title money or Chicago Title owes Seko money."

The Bankruptcy Court dismissed the involuntary petition and awarded to Seko a judgment against CTIC for the fees and costs incurred in defending the involuntary petition.

A three judge panel of Bankruptcy Judges on the Bankruptcy Appellate Panel unanimously affirmed, holding that these circumstances constituted a bona fide dispute that precluded CTIC from being a petitioning creditor. The Ninth Circuit Court of Appeals reversed based upon a new rule of law which dictates a result contrary to that which would be mandated in at least five other circuits, and rejecting both contrary authority clearly expressed by another Circuit Court and common sense.

REASONS FOR GRANTING THE WRIT

Certiorari is necessary to resolve a split of authority between the Circuits interpreting 11 U.S.C. § 303, and Bankruptcy Rule 1011, which are both frequently utilized rules of national application in which there is an overriding need for national uniformity. The opinion below has created a new general rule of law, not recognized in any other circuit, which, in effect, would authorize a creditor whose claim has been paid in full to put his former debtor into involuntary bankruptcy. The rule rejects the availability of the defense of a legitimate **setoff which exceeds the claim of the petitioning creditor** as the basis for disputing the claim of a petitioning creditor, limiting the alleged debtor's counterclaim defenses to those of **recoupment**. This new rule is in clear conflict with the rule as expressed in at least one other circuit, and as implied in at least four other circuits. The court in *Harris v. Capehart-Farnsworth Corp.*, 225 F.2d 268, 270 (8th Cir. 1955) held that,

> "the alleged bankrupt may set up any defense that would be available to him in a civil suit upon the claim; and that, in order to reduce the claims of petitioning creditors below the $500 minimum, **the bankrupt may file a counterclaim, including a set-off or a recoupment**." (Emphasis added).

The *Harris* case, though arising before the current Bankruptcy Code, is cited in the Committee Note to Bankruptcy Rule 1011 as the basis for subparagraph (d) which specifically authorizes assertion of an alleged debtor's claims against the petitioner for defensive use in defeating the petition. *Harris* has been cited favorably in a number of more recent cases. The decision in *Harris* has not been criticized by any court,

and the Ninth Circuit's rejection of the *Harris* approval of setoffs isn't even mentioned in the Ninth Circuit's opinion.

The proper interpretation of § 303, apparently rejected by the Ninth Circuit, but adopted in at least five circuits, is explained in *In re Sims*, 994 F.2d 210 (5th Cir., 1993) at page 220:

> "Although our court has not yet considered how to define a 'bona fide dispute', we find guidance from the Third, Seventh, Eighth, and Tenth Circuits, which have all adopted an objective standard, based on the reasoning of *In re Lough,* 57 Bankr. 993 (Bankr. E.D. Mich. 1986). Under that objective standard, the bankruptcy court must 'determine whether there is an objective basis for either a factual or a legal dispute as to the validity of the debt.' *In re Rimell*, 946 F.2d 1363, 1365 (8th Cir. 1991) (citing *Matter of Busick,* 831 F.2d 745, 750 (7th Cir. 1987), and *Bartmann v. Maverick Tube Corp.,* 853 F.2d 1540, 1544 (10th Cir. 1988)), cert. denied, ___ U.S. ___, 112 S. Ct. 2275 (1992); see also *B.D.W. Assoc. v. Busy Beaver Bldg. Centers, Inc.*, 865 F.2d 65, 66-67 (3d Cir. 1989) (a bona fide dispute exists if there are "'substantial' factual and legal questions raised by the debtor" bearing upon the debtor's liability). We adopt that objective standard, as well as the Eighth Circuit's methodology for applying it, which includes a clearly erroneous standard of review:
>
> > [T]he petitioning creditor must establish a prima facie case that no bona fide dispute exists. Once this is

done, the burden shifts to the debtor to present evidence demonstrating that a bona fide dispute does exist. Because the standard is objective, neither the debtor's subjective intent nor his subjective belief is sufficient to meet this burden. The court's objective is to ascertain whether a dispute that is bona fide exists; the court is not to actually resolve the dispute. This does not mean that the bankruptcy court is totally prohibited from addressing the legal merits of the alleged dispute; indeed, the bankruptcy court may be required to conduct a limited analysis of the legal issues in order to ascertain whether an objective legal basis for the dispute exists..."

In re Lough, 57 B.R. 993 (Bankr. E.D.Mich. 1986) states:

". . . if there is a bona fide dispute as to either the law or the facts, then the creditor does not qualify and the petition must be dismissed. The legislative history makes it clear that Congress intended to disqualify a creditor whenever there is **any legitimate basis** for the debtor not paying the debt, whether that basis is factual or legal. Congress plainly did not intend to require a debtor to pay a legitimately disputed debt simply to avoid the stigma of bankruptcy. Accordingly, if there is either a genuine issue of material fact that bears upon the debtor's liability, or a meritorious contention as to the application of law to

undisputed facts, then the petition must be dismissed." (Emphasis added).

Seko's contention that CTIC was in breach of a contract requiring CTIC to pay more money to Seko than CTIC claimed was owed to it by Seko is a, "legitimate basis for the debtor not paying the debt".

The lower courts here followed the directive of the five Circuits which have ruled on the issue in considering the evidence. The facts evidenced by the record are:

d. Seko obtained a number of title insurance policies from CTIC insuring either Seko and/or its lenders in the face amounts of $700,000, $350,000, $100,000, $400,000 and $3.5 million.

f. Seko's title to the real property failed.

h. CTIC pled in its state court complaint that, pursuant to the title policies, it **paid off the notes held by the encumbrance holders** on the property, $383,801.37 of principal and interest to one and $433,880.55 of principal and interest to the other.

j. CTIC filed suit against Seko claiming it was defrauded by Seko into issuing the policies and alleging that it "was damaged in the amount of the accrued and unpaid interest and principal when CTIC indemnified the lenders". As an alternative theory, CTIC pled that it was the assignee of the notes.

m. Seko disputed the claims of fraud, contended it was owed the balances under the policies, and filed a cross complaint against CTIC for breach of contract and tortious breach of the

insurer's duty of good faith and fair dealing.

Under these circumstances, the Ninth Circuit's characterization of the defenses asserted as being in the nature of setoff and not recoupment is erroneous. The fact of the matter is that the claims and counter claims here do not arise out of separate loan and insurance contracts. **In substance, all of the claims at issue arise out of insurance contract transactions**. But for the insurance contract transactions, CTIC would have no claim against Seko. The disputes at issue here are not disputes between lender and borrower, but rather disputes between insured and insurer.

Citizens Bank of Maryland v. Strumpf, 516 U.S. 16, 116 S.Ct. 286, 289, 133 L.Ed.2d 258 (1995) held:

> " ... a set-off is a counterclaim which the defendant may interpose by way of cross-action against the plaintiff. But, broadly speaking, it represents the right which one party has against another to use his claim in full or partial satisfaction of what he owes to the other. That right is constantly exercised by business men in making book entries whereby one mutual debt is applied against another. If the parties have not voluntarily made the entries, and suit is brought by one against the other, the defendant, to avoid a circuity of action, may interpose his mutual claim by way of defense, and if it exceeds that of the plaintiff, may recover for the difference. Such counterclaim can be asserted as a defense or by the voluntary act of the parties, because it is grounded on the absurdity of making A pay B when B owes A."

In this case Party A introduced evidence that it was owed $3.5 million by Party B. B introduced evidence that it was owed $1.0 million by A. After reviewing the evidence, the Bankruptcy Court held that it could not tell whether A owed B money or B owed A money. A's offset would be a complete defense to B's claim such that the requisite $10,000 undisputed claim did not exist, and consequently the Bankruptcy Court dismissed the involuntary bankruptcy petition. The Bankruptcy Appellate Panel, in a unanimous decision by three bankruptcy judges who deal with these issues regularly, affirmed that dismissal on grounds that those circumstances amounted to a "bona fide dispute" as that term is used in 11 U.S.C. § 303.

The Ninth Circuit has held that these circumstances do not constitute a dispute precluding B from putting A into involuntary bankruptcy because, the court erroneously states, the cross claims do not arise out of the same transaction. That position is contrary to the plain meaning of the statute, contrary to the express ruling of another circuit, contrary to the implied rulings of at least four other circuits, it is illogical and, to borrow the characterization of this court, non-recognition of the setoff defense is an "absurdity."

CONCLUSION

The Ninth Circuit has held that,

> "The practice of netting out the claims of debtors and their creditors only makes sense when a counterclaim for recoupment on a creditor's claim is involved. Such a counterclaim arises only out of the same transaction which forms the basis of the creditor's claim ..."

As noted above, this holding is in direct conflict with the rule expressed by the 8th Circuit in *Harris* and contrary to the plain meaning of both Bankruptcy Code § 303 and Bankruptcy Rule 1011. Rejecting a defense of payment in full by setoff is tantamount to what this court has characterized as an "absurdity". Only the grant of this petition for certiorari can eliminate this conflict between the circuits and make the interpretation of the Bankruptcy Code and the Bankruptcy Rules uniform. The facts herein show that the Ninth Circuit erred in characterizing the counterclaim at issue as being a setoff as it was actually in the nature of recoupment. Clarifying the differences between these two concepts and properly applying them to the facts of this case will be beneficial for the entire legal community.

WHEREFORE, Petitioner Seko Investments, Inc., prays that a writ of certiorari issue from this honorable court to review the judgment of the Court of the Appeals for the Ninth Circuit in *In re Seko Investment, Inc. (Chicago Title Insurance Company v. Seko Investment)*. In the event that the petition is granted, Petitioner prays that the judgment of the Court of Appeals for the Ninth Circuit be reversed and that the cause be remanded with directions to affirm the judgment

of the Bankruptcy Appellate Panel for the Ninth Circuit.

Respectfully submitted,

/s/_____

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APPENDIX A

Not for Publication

UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

[Filed November 13, 1998]

In re: SEKO INVESTMENT, INC., a Nevada Corporation, Debtor	)	
CHICAGO TITLE INSURANCE COMPANY, Appellant, v. SEKO INVESTMENT, INC., Appellee.	)	**ORDER** **No.96-56508** **BAP No. CC-95-01029-MeJO**

Before: KOZIÑSKI, O'SCANNLAIN and TROTT, Circuit Judges.

The panel has voted to deny the petition for rehearing. The full court has been advised of the suggestion for rehearing en banc and no active judge has requested a vote thereon. Fed. R. App. P. 35(b). The petition for rehearing is denied and the suggestion for rehearing en banc is rejected.

APPENDIX B

FOR PUBLICATION

UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

[Filed September 28, 1998]

In re: SEKO INVESTMENT, INC., a Nevada Corporation, Debtor CHICAGO TITLE INSURANCE COMPANY, Appellant, v. SEKO INVESTMENT, INC., Appellee.	**OPINION** **No.96-56508** **BAP No. CC-95-01029-MeJO**

Appeal from a Decision of the
Bankruptcy Appellate Panel

Opinion of the U.S. Court of Appeals for the 9th Circuit (9/28/98)

Meyers, Jones and Ollason,
Bankruptcy Judges, Presiding

Argued and Submitted
November 3, 1997--Pasadena, California

Filed September 28, 1998

Before: Alex Kozinski, Diarmuid F. O'Scannlain* and Stephen S. Trott, Circuit Judges.

Opinion by Judge Kozinski

SUMMARY

Bankruptcy/Claims

The court of appeals reversed a judgment of the bankruptcy appellate panel (BAP). The court held that under § 303(b) of the Bankruptcy Code, a counterclaim against a petitioning creditor does not per se render it subject to a "bona fide dispute," so long as the creditor establishes that there is no dispute regarding the debtor's liability on the creditor's claim.

Appellee Seko Investment, Inc. borrowed $750,000 from two lenders, pledging real estate as security. Appellant

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*Judge O'Scannlain was drawn to replace Judge Gibson who became unavailable.

Opinion of the U.S. Court of Appeals for the 9th Circuit (9/28/98)

Chicago Title Insurance Company issued title policies to the lenders and to Seko. When a third party brought an action to quiet title in the property, Chicago Title settled the lenders' claims under their policies, acquiring Seko's notes in the process.

Chicago Title sued Seko on the notes. Seko counterclaimed to enforce its title policy. Chicago Title asserted that it was not obligated to pay because Seko had obtained its policy by fraudulent means.

Chicago Title filed an involuntary Chapter 7 bankruptcy petition against Seko, asserting a claim based on the notes. Seko moved to dismiss the petition under § 303(b). Section 303(b) provides that the claim of a petitioning Chapter 7 creditor is disqualified if it is either contingent as to liability, or is "the subject of a bona fide dispute." Seko contended that its counterclaim would offset its liability on the notes; because the dispute over the title documents was unresolved, Seko asserted, Chicago Title might have a duty to indemnify Seko for losses arising out of the title failure.

The bankruptcy court agreed with Seko and dismissed Chicago Title's petition. The BAP affirmed. Chicago Title appealed.

[1] Section 303(b) prevents two types of claims from being the basis of an involuntary petition: those that are contingent as to liability and those that are the subject of a bona fide dispute. Both exceptions aim to prevent creditors from using the threat of an involuntary petition to bully an alleged debtor into settling a speculative or validly disputed

debt.

[2] Chicago Title's claim against Seko was not contingent as to liability. Claims are contingent as to liability when the debtor's duty arises only on the occurrence of a future event that was contemplated by the parties at the time of the contract's execution. Unless the claim was subject to a bona fide dispute, Chicago had standing to bring an involuntary petition.

[3] Section 303(b) is concerned with whether the creditor's claim is disputed. Although there may have been a dispute regarding who ultimately owed money to whom, Seko did not dispute the validity of the *claim* Chicago Title filed. If the lenders had not assigned their notes to Chicago Title, there would have been no dispute as to the validity of their claims, and their ability to file an involuntary petition. There was no reason why the result should have differed merely because the claims belonged to an entity against which Seko alleged it had a claim. The existence of a counterclaim against a creditor does not automatically render the creditor's claim "the subject of a bona fide dispute." So long as the creditor has established that there is no dispute regarding the debtor's liability on the creditor's claim, the creditor has standing to bring a petition.

[4] A counterclaim may serve to work a diminution or set-off of the claim of the petitioning creditor. Because the Bankruptcy Code requires that claims of petitioning creditors aggregate at least $10,000 more than the value of any lien on property of the debtor securing such claims held by the holders of such claims, this diminution can reduce a petitioning

creditor's claim so that the creditor is no longer eligible to file an involuntary petition.

[5] The practice of netting out the claims of debtors and their creditors makes sense only when a counterclaim for recoupment on a creditor's claim is involved. Such a counterclaim arises only out of the same transaction that forms the basis of the creditor's claim, not when the counterclaim originates in a separate transaction.

[6] Although recoupment is usually asserted by a creditor against a debtor, there is no reason why the principles should differ when the positions of the parties are reversed. Because recoupment operates akin to a defense against a claim, it can be seen as creating a dispute as to that claim in a way that a garden-variety counterclaim cannot. Courts have usually observed this requirement. This forces the accused bankrupt to allege a dispute as to the validity of the claim, and not merely to assert that the petitioning creditor owes it money in the aggregate.

[7] Seko's claim that Chicago Title owed it money based on its owner's title policy did not put in doubt the claims based on the notes assigned to Chicago Title. Title insurance contracts are contracts of indemnity, and absent a loss, there is no obligation to pay benefits. Chicago Title's notes did not implicate any loss based on title to the property. Whether or not it had good title was irrelevant to Seko's obligation to repay the money. If Seko believed that it had a claim under its title insurance policy, it could have brought that claim against Chicago Title. But doing so would not have disputed the validity of Chicago Title's claim under the notes.

[8] While a counterclaim will not defeat a creditor's *standing* to bring an involuntary petition, § 303(b) is not the last line of defense against abusive filings. A counterclaim may become relevant under subsection (h)(1): If a solvent person has missed payments on a debt simply because the creditor owes him money on an unrelated claim, the creditor may not be able to establish that he is "generally not paying" his debts. Although Seko's counterclaim did not create a bona fide dispute for purposes of § 303(b), Seko could still have used the counterclaim as evidence that it was solvent in the equity sense of "generally paying" its debts on time.

COUNSEL

Joseph K. Hegedus, Lewis, D'Amato, Brisbois & Bisgaard, Los Angeles, California, for the appellant.

Russell H. Rapoport, Plotkin, Rapoport & Nahmias, Encino, California, for the appellee.

OPINION

KOZINSKI, Circuit Judge:

We must decide whether section 303(b) of the Bankruptcy Code strips a creditor of standing to thrust a debtor into involuntary bankruptcy if the debtor asserts a counterclaim against the creditor.

Background

Seko, the accused bankrupt here, borrowed $750,000

from two lenders in 1986, pledging real estate as security. Chicago Title issued an owner's title insurance policy on the property to Seko and separate title insurance policies to the lenders. In 1988 things began to unravel. An unrelated company, alleging that Seko had doctored the title documents, claimed ownership of the property and commenced an action to quiet title. Seko immediately stopped paying the lenders on the promissory notes. With their security interest under attack and payment on the debt not forthcoming, the lenders complained to Chicago Title, who promptly settled the lenders' claims. In exchange, the lenders assigned their notes to Chicago Title. Chicago Title then sued Seko in state court for payment on the notes. Seko turned around and counterclaimed to enforce its own policy insuring the title on the property. Chicago Title refused to honor the policy, arguing that Seko had obtained the policy fraudulently by doctoring the title. Thus, two disputes had arisen: First, Chicago Title (as assignee of the lenders) wanted Seko to pay on the notes and, second, Seko wanted Chicago Title (as title insurer to Seko) to honor the owner's title policy.

Just before trial was set to begin in state court, Chicago Title filed an involuntary Chapter 7 petition against Seko in bankruptcy court. In filing the petition, Chicago Title put on only its lender's hat, as assignee of the promissory notes. Seko moved to have the petition dismissed on the ground that the claim was subject to a bona fide dispute under 11 U.S.C. § 303(b). Pointing to Chicago Title's role as title insurer, Seko argued that its counterclaim would offset its liability on the notes; because the dispute over the title documents remained unresolved, Seko argued, Chicago Title may have had a duty to indemnify Seko for losses arising out

of the title failure. The bankruptcy court held for Seko and dismissed the petition; the BAP affirmed.

Discussion

A creditor does not have standing to file an involuntary Chapter 7 petition if its claim is "contingent as to liability or the subject of a bona fide dispute." 11 U.S.C. § 303(b) (1994). Seko focuses on the term "bona fide dispute," arguing that its counterclaim under the title insurance policy disqualifies Chicago Title's claim.[1] Because Seko's counterclaim exceeds the amount of Chicago Title's claim, it could ultimately preclude judgment for Chicago Title. Thus, Seko argues, the claim is disputed.

[1] Section 303(b) is rather tight-lipped about the meaning of a "dispute," but it whispers enough hints to tell us that a counterclaim doesn't automatically render a claim

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[1]The parties focus on the adjective "bona fide," the meaning of which we have not yet addressed in this context. Other circuits have adopted an objective interpretation of the term. *See In re Sims,* 994 F.2d 210, 221 (5th Cir. 1993); *In re Rimell,* 946 F.2d 1363, 1365 (8th Cir. 1991); *Bartmann v. Maverick Tube Corp.,* 852 F.2d 1540, 1544 (10th Cir. 1988); *In re Busick,* 831 F.2d 745, 750 (7th Cir. 1987). Seko suggests a subjective standard, arguing that because its nonpayment of Chicago Title's claim was in good faith, there is a bona fide dispute. The ambiguity demonstrates why we should not use Latin where English will do. Because our resolution of the case turns on the meaning of "dispute," not "bona fide," we need not resolve the ambiguity here.

subject to dispute. We begin with the definition of a claim, the sine qua non of bankruptcy. The Bankruptcy Code defines claim quite broadly: "'Claim' means--right to payment, whether or not such right is reduced to judgment, liquidated, unliquidated, fixed, contingent, matured, unmatured, disputed, undisputed, legal, equitable, secured, or unsecured . . . ." 11 U.S.C. § 101(5)(A). Section 303(b) prevents two types of claims from being the basis of an involuntary petition: those that are "contingent as to liability" and those that are "the subject of a bona fide dispute."[2] Both exceptions aim to prevent creditors from using the threat of an involuntary petition to bully an alleged debtor into settling a speculative or validly disputed debt. *See* 2 Collier on Bankruptcy ¶ 303.031[2][b][i].

[2] Chicago Title's claim against Seko is not contingent as to liability. Claims are contingent as to liability when the debtor's duty to pay arises only upon the occurrence of a future event that was contemplated by the parties at the time of the contract's execution. *See In re Sims,* 994 F.2d at 220 (citing *In re Ail Media Properties, Inc.*, 5 B.R. 126, 132 (Bankr. S.D. Tex. 1980)). The classic example is a wager between two parties; until the wagered-on event comes to pass, both have contingent liabilities in the amount of the bet. No such future event is contemplated by the notes. Therefore, unless the claim is subject to a bona fide dispute, Chicago Title has standing to bring an involuntary petition.

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[2] The other requirements of section 303(b) aren't relevant to this appeal.

[3] Seko claims that it has raised a bona fide dispute because it has a separate claim against Chicago Title that, if found to be valid, would completely offset Chicago Title's claim against it. But the statute is not concerned with who ultimately owes money to whom; rather, it is concerned with whether the creditor's claim is disputed. Although there may be a dispute regarding who ultimately owes money to whom, Seko has not really disputed the validity of the *claim* filed by Chicago Title. Instead, it contends that its counterclaim against Chicago Title, if successful, could yield enough money to cancel out its debt on the notes. But if the two lenders had not assigned their notes to Chicago Title, there would be no dispute as to the validity of their claims and their concomitant ability to file an involuntary petition. We see no reason the result should differ merely because the claims now belong to an entity against which Seko alleges it has a claim. We therefore hold that the existence of a counterclaim against a creditor does not automatically render the creditor's claim the subject of a "bona fide dispute." So long as the petitioning creditor has established that there is no dispute regarding the debtor's liability on the creditor's claim, the creditor has standing under section 303(b) to bring a petition.

[4] Many courts have agreed that "the debtor's assertion of counterclaims, even if of substance, does not render the petitioner's claim the subject of a bona fide dispute." *In re Drexler, 56* B.R. 960, 969 (Bankr. S.D.N.Y. 1986); *accord In re Sims,* 994 F.2d at 221; *In re Audio Visual Workshop, Inc.,* 211 B.R. 154, 158-59 (Bankr. S.D.N.Y. 1997); *IBM Credit Corp. v. Compuhouse Systems, Inc.,* 179 B.R. 474, 479 (W.D. Pa. 1995). *But see Associated Elec. Supply Co. v. C.B.S. Elec. Sales Corp.,* 288 F.2d 683, 684-

85 (8th Cir. 1961). Those courts have further held, however, that a counterclaim may serve "to work a diminution or setoff of the claim of the petitioning creditors." *In re Drexler,* 56 B.R. at 969; *accord In re Audio Visual Workshop, Inc.*, 211 B.R. at 158. Because the Bankruptcy Code requires that the claims of petitioning creditors against a debtor "aggregate at least $10,000 more than the value of any lien on property of the debtor securing such claims held by the holders of such claims," 11 U.S.C. § 303(b), this diminution can reduce a petitioning creditor's claim so that the creditor is no longer eligible to file an involuntary petition.[3]

[5] The practice of netting out the claims of debtors and their creditors only makes sense when a counterclaim for recoupment on a creditor's claim is involved. Such a counterclaim arises only out of the same transaction which forms the basis of the creditor's claim, *see Newbery Corp. v. Fireman's Fund Ins. Co.*, 95 F.3d 1392, 1399 (9th Cir. 1996) (citing 4 Collier on Bankruptcy ¶ 553.03, at 513-15), and not when the counterclaim originates in a separate transaction. If recoupment applies, "the creditor's claim arises from the same trans-

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[3] This view is supported by Bankruptcy Rule 101 l(d), which states that "[a] claim against a petitioning creditor may not be asserted in the answer [to an involuntary petition] except for the purpose of defeating the petition." Bankr. R. 1011(d). Further support is found in the Advisory Committee's Note to Rule 1011(d), which favorably cites *Harris v. Capehart-Farnaworth Corp.*, 225 F.2d 268 (8th Cir. 1955). *Harris* held in part that an alleged debtor could use counterclaims "in diminution or extinguishment" of the claims of the creditors against whom the counterclaims were directed. *Id.* at 270.

action as the debtor's claim, [and] it is essentially a defense to the debtor's claim against the creditor rather than a mutual obligation." *Id.* at 1400 (quoting *In re B & L Oil Co.*, 782 F.2d 155, 157 (10th Cir. 1986)) (internal quotation marks omitted).

[6] Although recoupment is usually asserted by a creditor against a debtor, there is no reason the principles should differ when the positions of the parties are reversed. Because recoupment operates akin to a defense against a claim, it can properly be seen as creating a dispute as to that claim in a way that a garden-variety counterclaim cannot. When allowing counterclaims to offset claims, courts have generally observed this requirement. *See, e.g., In re J.B. Lovell Corp.*, 88 B.R. 459, 462 (Bankr. N.D. Ga. 1988) (a counterclaim for antitrust violations did not create bona fide dispute with respect to claim based on contract); *In re Kreidler Import Corp.*, 4 B.R. 256, 259 (Bankr. D. Md. 1980) (a counterclaim for liquidated damages on the contract that the petitioning creditor sued on created a bona fide dispute). This condition also accords with the text of section 303(b), by forcing the accused bankrupt to allege a dispute as to the validity of the claim, and not merely to assert that the petitioning creditor owes it money in the aggregate.

[7] Seko's claim that Chicago Title owes it money based on its owner's title insurance policy doesn't put in doubt the claims based on the notes assigned to Chicago Title. Title insurance contracts are contracts of indemnity, and "[a]bsent a 'loss' there is no obligation to pay benefits under a title policy." *Karl v. Commonwealth Land Title Ins. Co.*, 20 Cal. App. 4th 972, 978 (1993). Chicago Title's notes do not

implicate any sort of loss based on title to the property. The lenders advanced money to Seko, and Seko later ceased paying the debt it owed on the notes. Whether or not it held good title to the land is irrelevant to its obligation to repay the money.[4] Even though the failure of Seko's title caused Chicago Title to pay the lenders' claims under their separate title insurance policies, leading to Chicago Title's acquisition of the notes, this doesn't make the lenders' claims on these notes a loss caused by title defects vis-a-vis Seko; they existed because Seko received money and subsequently failed to pay it back as promised. If Seko believes it has a meritorious claim under its policy of title insurance it could certainly bring that claim against Chicago Title.[5] But doing so

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[4] Seko's obligation is the same whether it incurred the debt on an unsecured basis, on the basis of a security interest in chattel, or on the basis of a deed of trust on real estate as it did here. Further, it is unthinkable that Chicago Title could be required to defend a suit for payment on the notes brought by the lenders. It is true that "the duty to defend is broader than the duty to indemnify," *Horace Mann Ins. Co. v. Barbara* B., 4 Cal, 4th 1076, 1081 (1993), however, "the duty to defend, although broad, is not unlimited; it is measured by the nature and kinds of risks covered by the policy." *Waller v. Truck Ins. Exchange, Inc.*, 11 Cal. 4th 1, 19 (1995). If the lenders were to sue because the title to land was no good, the title insurance policy would require Chicago Title to defend the suit. However, an action to recover money owed under a loan contract is in no way the sort of risk covered by title insurance.

[5] Indeed, its loss and thus its damages might be enhanced by Chicago Title's failure to pay promptly if its claim is meritorious.

wouldn't dispute the validity of Chicago Title's claim under the notes.

[8] This reading of section 303 does not strip away its protection of accused bankrupts, forcing them to settle claims that they have good reason not to pay. While a counterclaim will not defeat a creditor's *standing* to bring an involuntary petition, section 303(b) is not the last line of defense against abusive filings. A more pertinent provision in cases of this sort is section 303(h)(1), which requires creditors to show equity insolvency.[6] A counterclaim may very well become relevant under subsection (h)(1): If a solvent person has missed payments on a debt simply because the creditor owes him money on an unrelated claim, the creditor may not be able to establish that he is "generally not paying" his debts.[7]

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[6] Creditors must show that "the debtor is generally not paying such debtor's debts as such debts become due unless such debts are the subject of a bona fide dispute." 11 U.S.C. § 303(h)(1).

[7] This may lead to the peculiar result that a counterclaim isn't a "bona fide dispute" under section 303(b), but is a "bona fide dispute" under section 303(h)(1). This result comes about not because "bona fide dispute" has a different meaning in the two subsections, but because it modifies different terms. *Compare* 11 U.S.C. § 303(b) (referring to "a claim against such person that is not, the subject of a bona fide dispute"), *with id.* § 303(h)(1) (allowing an alleged debtor to avoid an involuntary filing when the "debtor's debts . . . are the subject of a bona fide dispute"). It could certainly be the case that an alleged debtor docs not dispute its liability on a claim, but instead disputes whether it owes a debt overall, as Seko does here. This objection is properly dealt with

But if the alleged debtor isn't paying his debts generally (not just those owed to the petitioning creditor), the counterclaim will not be enough to keep the petition from going forward.[8] Thus, although Seko's counterclaim does not create a bona fide dispute for purposes of section 303(b), Seko may still use that counterclaim as evidence that it is in fact solvent in the equity sense of "generally paying" its debts on time.

Seko's counterclaim does not raise a bona fide dispute under section 303(b). The opinion of the BAP is **REVERSED** and the case is **REMANDED** for further proceedings consistent with this opinion.[9]

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under subsection (h), not subsection (b). As one court has noted, "the debtor's true protection against an improvident involuntary petition lies in the independent requirement of [Bankruptcy] Code § 303(h) that it be established that the debtor is generally not paying its debts as they become due." *In re Ross*, 63 B.R. 951,961 (Bankr. S.D.N.Y. 1986).

[8] Section 303(i) provides further protection against unwarranted involuntary petitions: If the petition is filed in bad faith, the bankruptcy court may award punitive damages in addition to any compensatory damages caused by the filing. *See* 11 U.S.C. § 303(i)(2).

[9] The BAP awarded attorney's fees to Seko. Because we reverse the BAP's holding on the merits, we also reverse the fcc award. Further, given our view of the merits, we decline to award Seko fees under Fed. R. App. P. 38 for its defense of this appeal.

APPENDIX C

UNITED STATES BANKRUPTCY APPELLATE PANEL
OF THE NINTH CIRCUIT

[Filed August 28, 1996]

In re: SEKO INVESTMENT, INC., a Nevada Corporation, Debtor	)
CHICAGO TITLE INSURANCE COMPANY, a Missouri Corporation Appellant, v.	) **MEMORANDUM**) **BAP Nos.**) **CC-95-1029-MeJO**) **CC-95-1202-MeJO**
SEKO INVESTMENT, INC., A Nevada Corporation Appellee.	) **Bankruptcy No.**) **LA93-29235 TD**

Argued and Submitted
June 20, 1996 in Pasadena, California

Memorandum of the Bankruptcy Appellate Panel for the 9th Circuit, (8/28/96)

Appeal from the United States Bankruptcy Court for the Central District of California

Hon. Thomas B. Donovan, Bankruptcy Judge, Presiding

Before: MEYERS, JONES and OLLASON, Bankruptcy Judges

I

These consolidated appeals arise from the bankruptcy court's orders dismissing an involuntary petition and awarding Seko Investment, Inc. ("Seko") attorney's fees in the amount of $44,615.55.

We AFFIRM.

II

FACTS

The facts recited by Chicago Title Insurance Company ("Chicago Title") begin in 1977, when Edith and Norman Rowland ("Rowlands") transferred property consisting of 60 acres to Saugus Land Company ("Saugus"). In 1981, Saugus executed a quitclaim deed for 80 acres in favor of Friendly Valley Equestrian Condo View Homes, Inc. ("Friendly Valley"). In 1984, an entity called Property Recovery Agency ("Property Recovery") asked the Rowlands to execute a quitclaim deed to transfer their interest in 58.75 acres ("Property") which was to be foreclosed upon by the taxing authorities. The Rowlands did so, although they told Property Recovery that they had already transferred the Property to Saugus. The name of Property Recovery was covered with white out on the deed and the name Robert Seanor ("Seanor") typed over it as the grantee before recording. In 1985, Seanor transferred his interest in the Property to Seko.

In 1986, Seko borrowed $750,000. The debt was

documented by two separate promissory Notes in the principal amounts of $350,000 and $400,000 ("Notes") which were secured by the Property. Although the preliminary title report indicated that fee title was vested in Friendly Valley, Chicago Title eventually issued lenders' policies for the debt and an owner's policy to Seko with a limit of $3.5 million. Chicago Title claimed that the policies were obtained by fraud of Seko's representatives in obtaining a "corrective deed" from the Rowlands which purportedly fixed the chain of title. The declarations of Bruce Friedman and Leonard Friedman, which Chicago Title included in the excerpts of record as part of Exhibit 27, claim that the title officer advised them how to correct the chain of title in favor of Seko.

In 1988, Friendly Valley sued Seko, its owners and lenders for slander of title, quiet title and to remove a cloud on its title to the Property. The complaint alleged that Seko's interest was obtained through fraud and was invalid. Seko stopped paying on the Notes and Chicago Title settled the lenders' claims for $817,681.92. In exchange, the lenders assigned their Notes to Chicago Title.

Chicago Title sued Seko and its owners in superior court to recover on the Notes and for fraud, negligent misrepresentation, breach of contract, as well as injunctive and declaratory relief that it had properly rescinded the title insurance policies. Seko filed cross-claims against Chicago Title for breach of contract and tortious breach of the insurers duty of good faith and fair dealing. In July of 1990, the superior court issued an order for a writ of attachment in favor of Chicago Title against all of Seko's property.

Memorandum of the Bankruptcy Appellate Panel for the 9th Circuit, (8/28/96)

On May 27, 1993, just 11 days before the superior court trial was to begin, Chicago Title filed an involuntary Chapter 7 petition against Seko. Besides Seko's lawyers, Chicago Title was Seko's only creditor. Seko filed a motion to dismiss the involuntary petition and a motion for relief from the automatic stay to allow the superior court trial to proceed. That trial was estimated to last for five or six weeks and involve between 40 and 100 witnesses. After a hearing on July 13, 1993, the bankruptcy court entered an order lifting the automatic stay and denying the motion to dismiss the involuntary petition without prejudice.

In August of 1994, Chicago Title filed a motion for summary judgment in the bankruptcy court for a determination of Seko's liability on the Notes. Seko responded with a cross motion for summary judgment seeking dismissal of the involuntary petition and damages under 11 U.S.C. § 303(i). Chicago Title relied on admissions contained in the Freidmans' declarations that Seko received the money from the lenders, executed the Notes and defaulted on the payment. Chicago Title urged the court to conclude that there was no dispute on the debt evidenced by the Notes which had been assigned to Chicago Title.

Seko argued that Chicago Title breached the title insurance policies, and furthermore, had no right to subrogation to the Notes of the lenders. Seko claimed that Chicago Title owed Seko far more than the value of the Notes for the loss incurred by Seko when title failed. The bankruptcy court denied Chicago Title's motion for summary judgment. At a second hearing, the court tentatively ruled in favor of Seko. On December 20, 1994, the court entered a

memorandum of decision and order disposing of the motions, dismissing the involuntary petition and granting Seko's request for reasonable attorney's fees under § 303(i) (1)[1]. After receiving further briefing on the amount of the fees, the court entered an order on February 6, 1995, awarding $44,615.55 as reimbursement of fees to Seko. The court found that amount to be reasonable and disallowed a bonus requested by the attorneys. Chicago Title filed timely appeals of each order.

The superior court suit was tried and judgment was entered in favor of Chicago Title and against Seko in December of 1995. Chicago Title supplied the Panel with copies of the superior court findings and judgment as part of its excerpts of record and refers to these documents throughout its briefs. These documents were deleted from the record by an order of the Panel which was entered April 1, 1996.

III

ISSUES

A. Whether Chicago Title qualified as a petitioning creditor at the time the bankruptcy court dismissed the involuntary petition.

B. Whether the bankruptcy court erred in not ruling on

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[1] All references to §, Section or Code are to the Bankruptcy Code, 11 U.S.C. §§ 101 - 1330.

Chicago Title's objections to evidence.

C. Whether the court abused its discretion in awarding Seko reimbursement of attorney's fees in the amount of $44,615.55.

IV

STANDARD OF REVIEW

A grant of summary judgment is reviewed de novo. Halverson v. Skagit County, 42 F.3d 1257, 1259 (9th Cir. 1994); In re Silva, 190 B.R. 889, 891 (9th Cir. BAP 1995). Whether a debt is contingent is a question of law subject to de novo review. In re Nicholes, 184 B.R. 82, 88 (9th Cir. BAP 1995).

Evidentiary rulings are reviewed for an abuse of discretion. Zenith Radio Corp. v. Hazeltine Research, 401 U.S. 321, 331-32 (1971). An award of attorney's fees under § 303(i) is reviewed for an abuse of discretion or an erroneous application of the law. In re Nordbrock, 772 F.2d 397, 400 (8th Cir. 1985); In re Wavelength, Inc., 61 B.R. 614, 621 (9th Cir. BAP 1986).

V

DISCUSSION

A. Whether Chicago Title Qualified as a Petitioning Creditor

When a debtor has fewer than twelve creditors, an

involuntary bankruptcy case may be commenced by the filing of a petition by one creditor which holds a claim against the debtor that is not contingent as to liability or the subject of a bona fide dispute. § 303(b)(2). If the petition is controverted, the court shall only order relief against the debtor if the debtor is generally not paying its debts as they become due unless such debts are the subject of a bona fide dispute. § 303(h)(1).

As originally enacted, the Code disqualified a creditor with a contingent claim from those eligible to file an involuntary petition, but not those holding claims that were subject to dispute. The courts noted that "[o]nly holders of claims that are contingent as to liability are denied the right to be petitioning creditors. It is significant that holders of unmatured, disputed and unliquidated claims are not specifically barred from being petitioning creditors." Matter of Covey, 650 F.2d 877, 881 (7th Cir. 1981), quoting In re All Media Properties, Inc. 5 B.R. 126, 132 (S. Tex. 1980). To correct a perceived inequity, Congress modified § 303 as part of the Bankruptcy Amendments and Federal Judgeship Act of 1984 by adding claims which are "the subject of a bona fide dispute" to both § 303(b)(1) and § 303(h) (1). The result was to also disqualify a creditor whose claim was the subject of a bona fide dispute from eligibility to file an involuntary petition. The term bona fide dispute is not defined in the Code.

The bankruptcy court explained the reason for dismissing the case and the methodology employed in reaching that decision. The court found:

> Many important disputed issues of fact are apparent from the record on these motions, but the disputed issues of fact relate to the underlying litigation between the parties. As to these motions, however, and the central question of Chicago Title's standing to petition for Seko's involuntary bankruptcy, the material facts are undisputed, insofar as they appear to be necessary to a determination of these motions.

The court framed the central question to decide as whether Chicago Title had standing to sustain an involuntary petition in bankruptcy against Seko. After reviewing § 303(b) and the undisputed facts, the court held that Chicago Title's claims against Seko were contingent because they must await a trial court determination of liability in favor of Chicago Title.

Chicago Title contends that its claim is not contingent because Seko's liability on the Notes is not dependant on the occurrence or happening of an extrinsic event. Seko agrees with this contention, but maintains that Chicago Title's claim is the subject of a bona fide dispute which required a trial for resolution.

Although the court may have used the wrong terminology, the resulting orders should be affirmed. "A bona fide dispute over liability does not render a claim contingent." In re Dill, 731 F.2d 629, 631 (9th Cir. 1984). However, a review of the record and consideration of the applicable standard lead to the conclusion that Chicago Title

was not eligible to file an involuntary petition against Seko because Chicago Title's claim was subject to a bona fide dispute at the time the involuntary bankruptcy was dismissed. Although, not yet addressed by the Ninth Circuit, five other Circuit Courts of Appeal have considered the definition of a bona fide dispute in the context of an involuntary petition. All five applied an objective standard identical or similar to that used in the case of In re Lough, 57 B.R. 993 (E.Mich. 1986), a case which was relied upon by the bankruptcy court. Matter of Sims, 994 F.2d 210, 221 (5th Cir. 1993); In re Rimell, 946 F.2d 1363, 1365 (8th Cir. 1991); B.D.W. Assoc. v. Busy Beaver Bldg. Centers, Inc., 865 F.2d 65, 66-67 (3d Cir. 1989); Bartmann v. Maverick Tube Corp., 853 F.2d 1540, 1544 (10th Cir. 1988); Matter of Busick, 831 F.2d 745, 750 (7th Cir. 1987). Under the standard enunciated by these cases, the bankruptcy court must determine whether there is an objective basis for either a factual or legal dispute as to the validity of the debt. If there is a bona fide dispute as to either the law or the facts, then the creditor does not qualify and the petition must be dismissed. The courts in Busick and Busy Beaver added the qualifier "substantial" to the requirement that there be a factual or legal dispute.

It is undisputed that Chicago Title insured Seko's title to the Property for up to $3.5 million and that Seko's title failed. The record contains declarations and deposition transcripts which contradict one another on the crucial issues concerning Seko's fraud in obtaining title insurance which required a trial for resolution. Chicago Title issued a letter notifying Seko that is was rescinding the insurance policies based upon fraud and also sued Seko and its agents to obtain the same result. Although Chicago Title filed over 3200 pages

as its excerpts of record, a review of the record as cited by, Chicago Title does not provide sufficient evidence to sustain a case of fraud which would result in the recision of the title insurance without a trial.

The fact that Chicago Title eventually won at the trial in the superior court after the bankruptcy case was dismissed is not relevant to this determination, as recognized by the Panel when it issued the order which deleted the superior court findings and judgment from Chicago Title's excerpts of record. At the time the involuntary petition was filed and dismissed, there was a bona fide dispute concerning fraud by Seko. This was a genuine issue of material fact which Chicago Title had to establish to rescind the title insurance policies which it had issued to Seko. The bulk of the submissions consist of copies of title reports, deeds and documents filed by Chicago Title in the superior court. The portions of the record cited to by Chicago Title to support its version of the facts is deficient because it relied heavily on the findings by the superior court after the 1995 trial. The deeds and excerpts of depositions do not supply the requisite elements to establish fraud by Seko and the Freidmans' declarations directly refute the testimony relied upon by Chicago Title.

Chicago Title argues that there was no dispute that Seko was liable for $1.43 million on the Notes which Chicago Title holds by assignment and that the money has been due since 1988. Chicago Title further contends that Seko's counterclaims were meritless and arose from a different transaction so they could not qualify to create a bona fide dispute as to the liability on the Notes. Chicago Title adds that the only evidence presented by Seko was the declaration

of the attorney representing Seko in the superior court and that his testimony concerning the facts of the case were hearsay and inadmissible. However, Chicago Title also submitted the Freidmans' declarations which demonstrate there was a significant issue of material fact.

Chicago Title cites several cases which hold that the debtor's assertion of a counter-claim arising from a different transaction does not render a creditor's claim subject to a bona fide dispute. However, the dispute in this case is over the validity of the title insurance and Chicago Title's ability to collect on the Notes from the insured.

Despite Chicago Title's continued attempts to segregate the liability on the Notes from the title insurance, the issues are intertwined and had been the subject of years of litigation at the time the involuntary petition was filed. In deciding whether to dismiss an involuntary petition, the court is to ascertain whether a dispute that is bona fide exists; the court is not to actually resolve the dispute. Rimell, supra, 946 F.2d at 1365. The court may be required to conduct a limited analysis of the legal issues in order to ascertain whether an objective legal basis for the dispute exists. Id.

The fact that the lawsuit had been pending for so long and was scheduled for 25 to 30 days of trial with between 40 and 100 witnesses is indicative of the existence of a bona fide dispute. One can also infer that if there was no bona fide dispute the superior, court lawsuit would have been disposed of by pre-trial motions before the lengthy trial was to begin.

In the typical setting, review of the trial court's finding

that a bona fide dispute exists would be subject to a clearly erroneous standard. Sims, supra, 994 F.2d at 221. However, since the issue was decided on cross-motions for summary judgment, the review becomes de novo. Silva, supra, 190 B.R. at 891. Even under the de novo standard of review, the bankruptcy court's conclusion that Chicago Title was not eligible to file an involuntary petition based on the standards set forth in Lough was correct. It was the classification of the claim as contingent rather than disputed that was in error. The order of dismissal will be affirmed.

B. Chicago Title's Objections to Evidence

Chicago Title claims that the bankruptcy court "inexplicably abstained from reviewing the evidence of Seko's fraudulent activities... and also failed to rule on the objections to evidence submitted by Seko." Chicago Title accuses the court of denying it the ability to exercise its right to federal remedies. The trial court explained in its memorandum of decision that it was relying only on the undisputed facts concerning the issuance of title insurance, the failure of title and the payment to the lenders. The court stated that it would make no judgment about whether Seko was correct, but just that they were attempting to litigate the grievance in a businesslike way.

By inference, the bankruptcy court sustained Chicago Title's objection to the declaration of Mr. Girardi and did not consider its contents. Likewise, it is not necessary for the Panel to consider the recitations contained in Mr. Girardi's declaration to conclude that the record presented shows that there was a substantial factual dispute concerning the

enforceability of Seko's title insurance policy.

C. Whether the Attorney's Fees Awarded are Reasonable

When the bankruptcy court dismisses an involuntary petition, court has discretion to award attorney's fees against a petitioning creditor under § 303(i) (1). Wavelength, supra, 61 B.R. at 621. The court reviewed the fees claimed by Seko, applied a lodestar analysis and allowed the fees requested for the hours actually spent. The court found that the fees were reasonable and disallowed the requested bonus.

The court concluded that the petition was filed primarily as a litigation stratagem to undermine Seko's efforts to litigate in superior court rather than to attain the bankruptcy court supervised administration of Seko's assets. The court added that this conclusion was not necessary to its decision. The circumstances of this case are quite unusual. Chicago Title is Seko's only creditor, other than the fees Seko owes to its lawyers. The use of the bankruptcy court as a forum for the trial and collection of a single disputed claim is a practice which has been condemned. Nordbrock, supra, 772 F.2d at 399. A lawsuit had been pending between these parties in superior court for three years and was rapidly approaching trial when the creditor filed the bankruptcy petition. The creditor already had a state court writ of attachment and other collection remedies available outside the bankruptcy system. Chicago Title explained that it filed the petition to avoid a mistrial if the debtor or its owners filed bankruptcy and to reduce the costs of litigation. However, even if Chicago Title had a valid reason to file the involuntary petition, it must meet the requirements of a petitioning creditor imposed by the

Code to avoid dismissal of the case and liability for the debtor's expenses.

There has been no showing that the court abused its discretion in requiring reimbursement of fees to Seko of $44,615.55 and that judgment will also be affirmed.

VI

CONCLUSION

Although Chicago Title's claim was not contingent, it was subject to a bona fide dispute. Therefore, Chicago Title was not eligible to file an involuntary petition against Seko. The order dismissing the involuntary petition is **AFFIRMED.** The award of attorney fees in the amount of $44,615.55 pursuant to § 303(i) was not an abuse of discretion and is also **AFFIRMED.**

Memorandum of the Bankruptcy Appellate Panel for the 9th Circuit, (8/28/96)

OFFICE OF THE CLERK
United States Bankruptcy Appellate Panel
of the Ninth Circuit

NOTICE OF ENTRY OF JUDGMENT

BAP No. CC-95-1029-MeJO
CC-95-1202-MeJO (consolidated)

In re SEKO INVESTMENTS, INC.

A separate Judgment was entered in this case on 8/28/96.

Motions for Rehearing

A motion for rehearing may be filed within 10 days after entry of the judgment. (Bankruptcy Rule 8015).

The motion shall be submitted on 8½ by 11 inch paper, shall not exceed 15 pages in length, and shall comply with rules governing service and signature. An original and three copies shall be filed.

A motion for rehearing may toll the time for filing a notice of appeal to the Court of Appeals. See Bankruptcy Rule 8015.

Bill of Costs

Bankruptcy Rule 8014 provides that costs on appeal shall be taxed by the Clerk of the Bankruptcy Court. Cost bills should be filed with the Clerk of the Bankruptcy Court from which the appeal was taken. Also see, Federal Rules of Appellate

Memorandum of the Bankruptcy Appellate Panel for the 9th Circuit, (8/28/96)

Procedure 39.

Issuance of the Mandate

The mandate, a certified copy of the judgment sent to the Clerk of the Bankruptcy Court from which the appeal was taken, will be issued 7 days after the expiration of the time for filing a petition for rehearing unless such a petition is filed or the time is shortened or enlarged by order. See Federal Rules of Appellate Procedure 41.

Appeal to Court of Appeals

An appeal to the Ninth Circuit Court of Appeals is initiated by filing a notice of appeal with the Clerk of this Panel. The Notice of Appeal should be accompanied by payment of the $100 filing fee. Checks may be made payable to the U.S. Court of Appeals For The Ninth Circuit. See Federal Rules of Appellate Procedure 6 and the corresponding Rules of the United States Court of Appeals for the Ninth Circuit for specific time requirements.

APPENDIX D

UNITED STATES BANKRUPTCY COURT
CENTRAL DISTRICT OF CALIFORNIA
LOS ANGELES, CALIFORNIA

In re: SEKO INVESTMENT, INC., a Nevada Corporation, Debtor SEKO INVESTMENT, INC. Movant v. CHICAGO TITLE INSURANCE COMPANY, a Missouri Corporation Respondent	)	**MOTION** **Case No.** **LA-93-29235-TD**

Los Angeles, California
October 20, 1994
11:00 a.m., Courtroom 1345

RECROSS-MOTION FOR SUMMARY JUDGMENT OR TO DISMISS

Partial Hearing Transcript on the Motion for Summary Judgment (10/20/94)

THE HONORABLE THOMAS B. DONOVAN,
PRESIDING UNITED STATES BANKRUPTCY
COURT JUDGE

COURT RECORDER:

WANDA TOLIVER
U.S. Bankruptcy Court

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FOR THE RESPONDENT:

Partial Hearing Transcript on the Motion for Summary Judgment (10/20/94)

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Partial Hearing Transcript on the Motion for Summary Judgment (10/20/94)

PROCEEDINGS BEGIN AT 11:00 A.M.

(Court is Called to Order)

THE COURT: Number 1, Seko.

MR. RAPOPORT: Good morning, Your Honor. Russell Rapoport, Plotkin, Rapoport & Nahmias on behalf of moving party Seko.

MR. CALHOUN: Good morning, Your Honor. Gordon Calhoun and Wayne Johnson upon -- on behalf of responding party Chicago Title.

THE COURT: Good morning.

MR. CALHOUN: Good morning.

THE COURT: This case which is here on cross motion again, is quite complex and difficult and is filled with all kinds of interesting things. And it's been a struggle for me. But, I've come to a conclusion, and it is this: Seko's motion will be granted. And it will be granted for the reason that I feel that it falls under Section 303. For the reason that -- or rather Chicago Title's participation as a petitioning creditor on an involuntary petition, falls within the prohibition of Section 303 in that, one way or the other, the liability that Chicago Title asserts is not certain, it is contingent or while the underlying liability is not in dispute or the subject of a dispute, or a bona fide dispute in the language of the statute, when the totality of the circumstances are considered it is clearly uncertain whether Seko owes Chicago Title money or

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Chicago Title owes Seko money.

And for that reason it seems to me that while the statute does not perhaps express the matter in a way that is completely commensurate with the needs of this case, it seems to me when I looked at the spirit of the statute and look at the words of the statute I have to conclude that both the spirit and the words lead me to the conclusion that in this case bankruptcy at the instance of involuntary petition by Chicago Title is inappropriate and is asserted in a aggressive way that is inconsistent with the purpose of the bankruptcy laws which are to administer assets of somebody or an entity that's not paying its bills.

Seko doesn't have anything other than its lawsuit against Chicago Title. And I think based on the proceedings in this court, all of which I'm taking judicial notice of, to the extent that that judicial notice is appropriate, it's pretty clear to me that Seko has a legitimate grievance and is seeking to -- seeking in a businesslike way to litigate that grievance. And that if Seko is correct, and I make no judgment about whether Seko is correct or not, then Chicago Title may end up owing Seko a large sum of money well in excess of the amount of money that -- that Chicago -- Seko owes Chicago Title.

I might point out there's a very interesting -- what I find to be a very interesting case, In Re: Lough, L-O-U-G-H, 57-BR-993, which I think comes to a similar conclusion. I think there is room for disagreement about the statute and I'm not aware of any 9th Circuit authority on the subject. But I find words in the Lough opinion that I think add to my conclusion that bankruptcy, Chicago Title's instance in this

case, is not permissible under Section 303.

Does any -- I'm happy to listen to argument, but I wanted to tell you beforehand that I gave a lot of thought to the motion the last time it was here. I've given a lot of thought to the motion this time. I've read the papers carefully and it is only after a lot of soul searching that I came to this conclusion and I feel this conclusion pretty strongly.

APPENDIX E

UNITED STATES BANKRUPTCY COURT
CENTRAL DISTRICT OF CALIFORNIA

In re: SEKO INVESTMENT, INC., Debtor CHICAGO TITLE INS. CO., Movant v. SEKO INVESTMENTS, INC., Respondent	) Case No. LA93-292-35TD) Chapter 7) **MEMORANDUM OF DECISION RE MOTIONS FOR SUMMARY JUDGMENT AND ORDER THEREON**

The cross motions of Seko Investments, Inc. (Seko), and Chicago Title Insurance Company (CTIC) for summary judgment were heard on October 20, 1994. Both parties submitted post-hearing briefs. The court hereby confirms its tentative ruling that was announced at the outset of the hearing on October 20. Seko's motion for summary judgment is granted. CTIC's motion for summary judgment is denied. CTIC's involuntary petition in bankruptcy is dismissed. Seko shall be awarded Seko's reasonable attorneys' fees, pursuant

to the provisions of 11 U.S.C. § 303(i)(1). The amount of such fees shall be determined upon written application by Seko, upon notice to CTIC.

Many important disputed issues of fact are apparent from the record on these motions, but the disputed issues of fact relate to the underlying litigation between the parties. As to these motions, however, and the central question of CTIC's standing to petition for Seko's involuntary bankruptcy, the material facts are undisputed, insofar as they appear to be necessary to a determination of these motions, and can be stated succinctly, as follows:

CTIC issued policies of title insurance to Seko, as owner of certain real estate, and to Seko's lenders. Title failed. CTIC paid $817,681.92 to Seko's lenders who also were insured by CTIC, and in return CTIC received assignments of two promissory notes from the lenders. Later, as a result of the forgoing events, CTIC sued Seko in the superior court to collect on the promissory notes. CTIC claims, among other things, that Seko obtained CTIC's title insurance policies fraudulently, that Seko's policies therefore are unenforceable, that Seko is entitled to no recovery and, further, that Seko is liable by reason of subrogation theories for CTIC's losses to Seko's lenders. CTIC seeks a declaratory judgment and damages for breach of contract, for breach of an implied covenant of good faith and fair dealing, fraud and negligent misrepresentation.

CTIC concedes that the real estate in question is worth something in the neighborhood of $1,300,000, though Seko claims it is worth more. Seko contends that CTIC was

obliged to pay Seko's lenders under the terms of CTIC's title insurance policies and that as a result CTIC is not entitled to recover monies paid to Seko's lenders under subrogation theories.

Seko in turn sued CTIC for damages based on CTIC's failure to defend and indemnify Seko from the third party quiet title action resulting from the failure of title to Seko's real property. Shortly before the CTIC-Seko disputes were scheduled to go to trial in the superior court, CTIC filed its involuntary petition in bankruptcy against Seko. These cross motions followed.

The central question is whether CTIC has standing to sustain an involuntary petition in bankruptcy against Seko. In this regard, 11 U.S.C. § 303(b) provides in part:

> An involuntary case against a person is commenced by the filing with the bankruptcy court of a petition under chapter 7 or 11 of this title--
>
> (1) by three or more entities, each of which is either a holder of a claim against such person that is not contingent as to liability or the subject of a bona fide dispute, or an indenture trustee representing such a holder, if such claims aggregate at least $5,000 more than the value of any lien on property of the debtor securing such claims held by the holders of such claims ....

The first question then is whether CTIC is a proper party to file an involuntary petition. The answer to that question turns on the threshold question whether CTIC holds a claim against Seko that is not contingent.

On, the basis of the foregoing undisputed facts, CTIC's claims against Seko are contingent; they must await a trial court determination of liability in favor of CTIC.

Meanwhile, it is undisputed that CTIC issued policies of title insurance to Seko for amounts up to $3,500,000, that Seko's title failed, and that CTIC may be liable to Seko under these policies for at least $1,300,000, more or less, an amount that CTIC concedes the real estate may be worth.

The conclusion follows that CTIC does not have a claim against Seko that is "not contingent as to liability." To the contrary, all claims discussed here are contingent, except the claim that CTIC issued title insurance to Seko. Thus, CTIC does not meet the standard of 11 U.S.C. § 303(b), CTIC has no standing to petition for Seko's involuntary bankruptcy, and CTIC's involuntary petition must be dismissed.

Although not necessary to the court's decision on the cross motions in issue, the court concludes from the record herein that CTIC's involuntary petition was filed not primarily to attain the bankruptcy court supervised administration of Seko's assets but, rather, primarily as a litigation stratagem to undermine Seko's efforts (1) to prosecute Seko's state court claims against CTIC and (2) to defend against CTIC's state court claims. The involuntary petition was filed at a time

when Seko had few resources at its disposal to sustain Seko in either struggle. The court concludes that the resolution of these competing claims is better left to the state court.

This memorandum will supplement the court's tentative ruling on October 20 and constitutes the court's findings of fact and conclusions of law.

Dated: December 20, 1994

/s/_____
THOMAS B. DONOVAN
Bankruptcy Judge

ORDER

IT IS ORDERED that Seko's motion for summary judgment is granted.

IT IS FURTHER ORDERED that CTIC's motion for summary judgment is denied.

IT IS FURTHER ORDERED that CTIC's involuntary petition in bankruptcy is dismissed.

IT IS FURTHER ORDERED that Seko shall be awarded Seko's reasonable attorneys' fees, pursuant to the provisions of 11 U.S.C. § 303(i)(1). The amount of such fees shall be determined upon written application by Seko, upon notice to CTIC.

Dated: December 20, 1994
/s/ _____
THOMAS B. DONOVAN
Bankruptcy Judge

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Dated: December 20 1994

/s/ _____
Clerk